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TREASURY FOR MATTHEW MALLOY
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SUBJECT: Argentina: 2008 Investment Climate Statement

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Openness to Foreign Investment

11. Argentina remains open to foreign investment. Five consecutive years of real GDP growth over 8 percent have attracted considerable U.S. and other international investor interest in exploring opportunities in the Argentine market. The government of Argentina, in turn, has signaled its desire to see foreign direct investment (FDI) expand significantly to enhance the nation's productive capacity and sustain high levels of real GDP growth. However, legal uncertainties concerning creditor and contract rights and frequent and unpredictable regulatory changes diminish the attractiveness of some sectors for foreign investors.

In 1991, the government of Argentina (GOA) pegged the Argentine peso to the U.S. dollar at a 1:1 exchange rate ("convertibility") with the aim of breaking the back of hyperinflation and adopted far-reaching market-based policies, including dismantling a web of protectionist trade and business regulations, and reversing a half century of statism by implementing an ambitious privatization program. Argentina subsequently received significant increases in investment, with FDI inflows among the highest in Latin America through most of the 1990s. While convertibility defeated inflation, over time the rigidity that it imposed on exchange rate policy, combined with lack of fiscal discipline and poor governance, undermined Argentina's export competitiveness and created chronic deficits in the current account of the balance of payments, which were financed by massive borrowing. The contagion effect of the Asian financial crisis of 1998 precipitated an outflow of capital that contributed to a four-year recession that culminated in a financial panic in

November 2001.

In January 2002, the government ended convertibility and defaulted on roughly \$82 billion in privately held debt and over \$6 billion in debt to official government creditors (including approximately \$360 million owed to the U.S. government). In February 2005, private investors holding 76 percent of Argentina's defaulted debt accepted an Argentine government offer of approximately 30 cents on the dollar of old debt. Some remaining "holdout" private bondholders are still actively seeking redress but, as of this writing, the GOA has declined to deal with private bondholders who chose not to participate in the 2005 restructuring. Of the over \$6 billion owed to official government creditors, over \$4 billion consists of arrears and past-due interest. The GOA has indicated interest in normalizing its relationship with official government creditors.

Argentina posted real GDP growth of 8.8 percent in 2003, 9.0 percent in 2004, 9.2 percent in 2005, 8.4 percent in 2006, and an estimated 8.5 percent in 2007. This impressive economic recovery, which has also led to improvements in key socio-economic indicators, can be attributed to a number of factors. These include Argentina's post-crisis move to a flexible exchange rate regime, sustained global and regional growth, a boost in domestic aggregate demand via monetary, fiscal and income distribution policies, favorable international commodity prices, and interest rate trends.

New taxes, better collecting efforts, and the recovery's strong impact on revenues have allowed the government to record primary fiscal surpluses in recent years. The 2006 federal primary surplus amounted to 3.5 percent of GDP, and is estimated at 3.3 - 3.48 percent of GDP in 2007, although this declined to roughly 2.3 - 2.5 percent of GDP when excluding a one-time adjustment due to changes in Argentina's pension regime). The government projects a primary fiscal surplus of about 3.5 percent in 2008.

Argentina should continue to perform well, with the Central Bank of Argentina's consensus survey forecasting 6.6 percent real GDP growth for 2008. A range of economic experts have identified challenges to sustaining high levels of economic growth in the future, including: capacity constraints; the need for substantial new investment in primary infrastructure; potential energy shortages in the face of high growth and domestic energy prices maintained by the government below international market levels; increasing scarcity of highly skilled labor; inflation (8.5 percent in 2007 according to official statistics, but estimated by independent analysts to be significantly higher) and the government's heterodox policies to contain it, including pressure on the private sector to limit price increases via "price stabilization" agreements; and delays addressing the post-crisis renegotiation of public service contracts.

The industrial sector has performed well, growing from 16 percent of GDP in 2001 to 22.3 percent in 2006. Illustrative of this industrial expansion, the domestic car industry had its best year in history in 2007, with production reaching 544,647 units, up 26% from 2006. Automotive exports reached 316,410 units in 2007, also an all-time record, and comprising about 58% of total production. In 2007, the automotive industry accounted for almost 20% of Argentina's manufacturing output and 36% of all manufacturing exports, measured by value.

Argentina's economic expansion continues to create jobs, and unemployment continues to decline, down from a 21.5 percent peak in 2002 to 8.8 percent during the third quarter of 2007 according to official government statistics. Investment in real terms, according to consensus forecasts published by the Central Bank, was estimated to have increased 13.8 percent in 2007. Meanwhile, the move from convertibility to a managed float

exchange rate regime and high global commodity prices have lifted the value of exports to record levels. A substantial foreign exchange reserve cushion (\$46 billion as of December 2007) has also helped insulate the economy from external shocks. In January 2006, the GOA used reserves to pay down its \$9.5 billion debt to the IMF.

Argentina's Central Bank has managed monetary and currency policy in support of the economic expansion, maintaining an undervalued or "competitive" exchange rate and negative real interest rates. Such policies have contributed to substantial inflationary pressures. To help control inflation, the government largely froze key public utility tariff rates since 2002 and, since 2005, has negotiated price stabilization agreements on a sizeable basket of essential consumer goods.

Private sector bank balance sheets, which deteriorated significantly during the economic crisis, are recovering, with improving levels of liquidity, net exposure to the public sector significantly reduced, and credit - primarily to the private sector - increasing at a faster pace than nominal GDP growth. According to private rating agencies, most private banks (which hold approximately 55 percent of total financial system deposits and 67 percent of loans) have returned to solvency. The ratio of private bank non-performing loans has fallen to an historic low of approximately 2.5 percent, and profits for the overall banking system are among the highest levels achieved in over a decade. According to central bank regulatory authorities, public banks, which hold the remaining assets, are also solvent and liquid. However, system-wide, new lending is mostly short-term, as access to long-term financing is limited and borrowers are reluctant to borrow long-term at variable rates. Uncertainty about the levels of long-term inflation will continue to complicate GOA and private sector efforts to develop a long-term fixed interest rate market, without which it will be difficult to deepen Argentina's financial markets or support large-scale project finance. Government officials have acknowledged the lack of medium- and long-term credit facilities needed to support the expansion of domestic productive capacity and, according to media reports, are considering whether and how to structure a state-supported long-term financing vehicle.

Decree 1853/1993 governs foreign investment in Argentina. According to this decree, foreign companies may invest in Argentina without registration or prior government approval, and on the same terms as investors domiciled in Argentina. Investors are free to enter Argentina through merger, acquisition, greenfield investment, or joint venture. Foreign firms may also participate in publicly financed research and development programs on a national treatment basis. In June 2003, Argentina enacted legislation limiting foreign ownership of "cultural goods," which includes media and Internet companies, to 30 percent. An exception to the 30 percent limit is made for investors from those countries whose foreign investment regimes allow more than 30 percent foreign ownership of cultural goods. This law also exempts media companies from "cramdown" (or a bankruptcy court's enforcement of a reorganization plan despite the objections of some creditors) rules in restructuring and bankruptcy.

A Bilateral Investment Treaty (BIT) between Argentina and the United States entered into force in October 1994. The BIT provides protections against capital movement restrictions, expropriations, and performance requirements; it also establishes effective means for the settlement of investment disputes. The BIT lists a few sectors in which Argentina maintains exceptions to national treatment for U.S. investors: real estate in border areas, air transportation, shipbuilding, nuclear energy, uranium mining, and fishing. U.S. investors must obtain permission from the Ministry of Defense's Superintendency for Frontiers to invest in non-mining activities in border areas.

Foreign and Argentine firms face the same tax liabilities. In general, taxes are assessed on consumption, imports and exports, assets, financial transactions, and property and payroll (social security and related benefits). In June 2003, Argentina announced that it would review more closely the tax declarations of foreign corporations operating in Argentina. The professed aim of this measure is to crack down on the use of offshore shell corporations to shelter profits and assets from taxation.

The GOA has established a number of investment promotion programs. Those programs allow for VAT refunds and accelerated depreciation of capital goods for investors (although numerous investors have reported difficulties and delays in obtaining expected VAT refunds); offer tariff incentives for local production of capital goods; and include sectoral programs, free trade zones, and a Special Customs Area (SCA) in Tierra del Fuego, among other benefits. A complete description of the scope and scale of Argentina's investment promotion programs and regimes can be found at <http://www.industria.gov.ar> and <http://www.prosperar.gov.ar>. Information about programs that specifically apply to small and medium businesses may be found at <http://www.sepyme.gov.ar>.

According to the World Bank's latest "Doing Business" survey, Argentina in 2007 ranked 109 out of 178 nations and territories surveyed in overall "ease of doing business," down from 101 in 2006. The survey considered issues such as: starting a business; dealing with licenses; employing workers; registering property; getting credit; protecting investors; paying taxes; trading across borders; enforcing contracts; and closing a business.

Conversion and Transfer Policies

¶2. Until the end of 2001, Argentine law offered a number of protections for free capital and currency transfers. Law 21382, Article 5 (as implemented by Decree 1853/1993) allows foreign investors to repatriate capital and remit earnings abroad at any time. Article V of the United States-Argentina BIT also provides for free, prompt transfers related to investments. In the wake of the 2001-2002 crisis, however, the GOA instituted and subsequently modified an array of emergency transfer and currency conversion restrictions. The number of new regulations and policy changes has generated considerable uncertainty for investors.

The Argentine Ministry of Economy and the Central Bank have issued various new or revised foreign exchange transaction regulations in an attempt to normalize the foreign exchange market and to limit the peso's appreciation. In nominal terms, the Argentine peso depreciated 70 percent in 2002, following the financial crisis that began in December 2001. The peso subsequently appreciated 15 percent against the USD in nominal terms in 2003, and slightly depreciated by two percent in 2004, two percent in 2005, one percent in 2006, and three percent in 2007.

Argentina imposed limited capital controls in July 2003 through Decree 285/2003, which establishes a regime for capital inflows and outflows. The decree obliges investors to keep foreign currency inflows in the country for a period of at least 180 days. In June 2005, the government further tightened capital controls through Decree 616/2005. The decree increased the minimum holding period for capital inflows from 180 to 365 days and established that some capital inflows are subject to a 30 percent unremunerated reserve requirement to be deposited in a local bank for 365 days. This deposit must be denominated in U.S. dollars and the proceeds cannot be used as collateral. The remaining 70 percent is free to be invested, but is subject to the 365-day minimum holding period. Capital inflows related to trade transactions, foreign direct investment, or to

primary public offerings of stock or bonds (from both the private and public sector) as well as inflows from International Financial Institutions are exempt from controls. Decree 616 diverged from previous regulation, as it attempted to discourage capital inflows by increasing the cost of bringing capital into the country.

A resident individual or company is allowed to purchase up to USD 2 million per month of foreign currency without Central Bank authorization. Any excess is subject to the restrictions (e.g., 30 percent reserve requirement and 365-day minimum investment period). In December 2006, the Central Bank established that capital inflows and outflows must be registered under a person's or business' name, whereas in the past transactions could be registered generically under the local brokerage/exchange house. There are special rules regulating the purchase of foreign currency to settle financial debt, and for the private issuance of bonds denominated in foreign currency.

Decree 260/2002 lifted official conversion rates that had been established in early 2002. With this decree, the market determines the rate of exchange, with Central Bank intervention, and subject to rules established by the Central Bank. The Central Bank intervenes frequently in the foreign exchange market, with the objective of maintaining a competitive peso.

Expropriation and Compensation

13. Article 4 of the United States-Argentina BIT states that investments shall not be expropriated or nationalized except for public purpose upon payment of prompt fair-market value compensation. However, some U.S. investors claim the January 2002 pesification of dollar-denominated contracts amounts to an effective expropriation of their investments. A number of these investors have filed international arbitration claims against the government of Argentina (see Dispute Settlement Section).

Dispute Settlement

14. The GOA accepts the principle of international arbitration. The United States-Argentina BIT provides for binding international arbitration of investment disputes that cannot be settled through amicable consultation and negotiation between the parties. The Government of Argentina is a party to the International Center for the Settlement of Investment Disputes (ICSID), the United Nations Commission on International Trade Law (UNCITRAL), and the World Bank's Multilateral Investment Guarantee Agency (MIGA). Companies that seek recourse through Argentine courts, however, may not also pursue recourse through international arbitration.

In April 2003, the GOA issued Decree 926/2003, which created two new agencies to carry out negotiations under bilateral investment treaties, including the United States-Argentina BIT. The "Amicable Negotiations Federal Council" (ANFC) made up of representatives of the Ministry of Foreign Affairs, the Ministry of Economy and the Federal Treasury Attorney, had a mission to devise the government's strategies and policies in negotiations with foreign investors and could approve proposals made during negotiations. However, in July 2003, that body was replaced by the "Unit for the Renegotiation and Analysis of Utility Contracts" (UNIREN), which was created to serve essentially the same function, but which is presided over jointly by the Ministers of Planning and Economy. The other entity created by Decree 926/2003 is the "Amicable Negotiations Proceedings Body," which works under the Federal Treasury Attorney. It receives investor complaints, gathers information and carries out negotiations with foreign investors.

In a December 2006 decision on the 2002 pesification decree, the Supreme Court ordered banks to reimburse depositors in local currency the total value of deposits originally held in U.S. dollars that had earlier been frozen. The decision also upheld the legality of this pesification decree, which froze bank deposits and forcibly converted dollar savings into devalued pesos. The ruling ordered banks to compensate depositors at 3.08 pesos to the dollar -- equal to the pesified deposits they would now hold under the original decree, and applying a currency conversion rate of 1.40 pesos per dollar, adjusting for inflation and adding a four percent annual interest rate to be applied retroactively since the pesification began.

Domestic investment dispute adjudication is available through local courts or administrative procedures. However, independent surveys indicate that public confidence in the Argentine judiciary remains weak. Therefore, many foreign investors rely on private or international arbitration when those options are available. Argentina has a strict bankruptcy law similar to that of the United States. However, initiating bankruptcy proceedings is more difficult in Argentina, and there have been allegations of corruption in the administration of bankruptcies and the selection of bankruptcy trustees. Creditors can participate in a Chapter 11-like procedure to determine the best means of recovering debts from a bankrupt firm. Company directors are personally and criminally responsible in cases of fraud, although severe punishment for white-collar crime is rare.

A number of U.S. investors have filed ICSID arbitration claims against the government of Argentina. Most of these investors consider the January 2002 pesification of dollar-denominated contracts, and/or the ex post facto prohibition on contracts linked to foreign inflation indices, to be an effective expropriation of their investments. Prior to pesification, some U.S. investors engaged in disputes with provincial governments over unforeseen changes in tax laws and liabilities (often in spite of tax-stability guarantees from provincial and federal authorities). Customs treatment and the freeze on public utility rate changes have also provoked investment disagreements. There were 33 pending cases involving Argentina before the ICSID tribunal as of mid-December 2007, 32 percent of total pending ICSID cases, with total claims of over USD 13 billion. Fourteen of these pending ICSID cases have been filed under the U.S. BIT. Over the past three years, several ICSID claimants who represent a substantial share of total claims against Argentina have suspended their ICSID proceedings to facilitate further negotiation with the government. A number of the pending cases are reaching their final conclusion and, in one case, a final judgment of over \$100 million against Argentina has been upheld. Government payment to the U.S. claimant under this ICSID final award remains pending.

Performance Requirements/Incentives

15. No performance requirements are aimed specifically at foreign investors. Government incentives apply to both foreign and domestic firms. The Ministry of Economy administers a complex trade-balancing regime involving quotas and tariffs for auto manufacturers including minimum-content and other requirements. Special regimes also apply to mining, oil and gas, and other natural resource sectors. The special regimes allow producers to keep all (as in the case of mining) or 70 percent of their foreign exchange revenues off-shore (as in the case of oil and gas).

Right to Private Ownership and Establishment

¶ 6. Foreign and domestic investors have free and equal rights to establish and own businesses, or to acquire and dispose of interests in businesses without discrimination. However, as noted above, in June 2003 Argentina enacted legislation limiting foreign ownership of "cultural goods," which includes media and Internet service providers companies, to 30 percent. An exception to the 30 percent limit is made for investors from those countries whose foreign investment regimes allow more than 30 percent foreign ownership of cultural goods.

Protection of Property Rights

¶ 7. Secured interests in property, including mortgages, are recognized and common in Argentina. Such interests can be easily and effectively registered. They also can be readily bought and sold. However, in February 2002, the government of Argentina established an extended moratorium prohibiting financial institutions from foreclosing on delinquent mortgages on primary residences and implemented a special procedure for both parties to reach an agreement for repaying the mortgage. This special procedure is only applied when delinquency in payment occurred from January 2001 to September 2003.

The government of Argentina adheres to most treaties and international agreements on intellectual property and belongs to the World Intellectual Property Organization and the World Trade Organization (WTO). The Argentine Congress ratified the Uruguay Round agreements, including the provisions on intellectual property, in Law 24425 on January 5, 1995. However, enforcement of intellectual property rights is problematic in Argentina. Argentina has been on the Office of the U.S. Trade Representative's intellectual property rights "Priority Watch List" since ¶ 1996.

Patents: Patent protection is an ongoing problem in Argentina's intellectual property rights regime, and extension of adequate patent protection to pharmaceuticals has been a highly contentious bilateral issue. In April 2002, the United States and Argentina reached an agreement with respect to most of the claims in a World Trade Organization (WTO) dispute brought by the United States with respect to Argentina's implementation of its TRIPS obligations. Two issues, including the critical issue of data protection, remain unresolved. The United States and Argentina have agreed to leave these issues within the WTO dispute settlement mechanism for action. New patent legislation implementing part of the April 2002 agreement was passed in December 2003. However, some U.S. and European pharmaceutical firms are concerned that provisions in the legislation, in practice, undercut their ability to protect patented products through judicial injunctions.

Copyrights, Trademarks, Trade Secrets, and Semiconductor Chip Layout Design

Despite the fact that Argentina's copyright law dates to 1930, it provides a generally good legal framework to protect intellectual property such as books, films, music, and software. However, the economic crisis of 2002 led to an increase in the use of unlicensed software and optical media. Piracy rates of CDs, DVDs, and software are estimated at over 60 percent. Enforcement continues to be sporadic and pirated products are widely available in the market. That said, Argentine authorities began in late 2004 to show signs of a more proactive posture regarding product piracy. Specifically, the government of Argentina passed laws designed to allow authorities to mount undercover operations for the first time; to electronically flag suspect shipments; to facilitate the seizure and detention of suspect merchandise; and to more frequently rotate customs personnel, among other provisions. A January 2005 law which allowed Customs officials to seize shipments which violate IP rights - and detain them based on the

presumption of IP violations, pending a formal decision - has not been implemented. The government has also improved the process for trademark registration, decreasing the time needed and increasing the rate at which trademarks are registered. However, the trademark law, passed in 1980, provides what are widely considered to be non-deterrant civil damages, and in criminal cases the judiciary is reluctant to impose deterrent penalties such as prison sentences. Argentina has no specific law on trade secrets, although penalties for unauthorized revelation of secrets are applied to a limited degree under commercial law. Argentina has signed the WIPO Treaty on Integrated Circuits, but has no law dealing specifically with the protection of layout designs and semiconductors.

Transparency of the Regulatory System

¶8. During the 1990s, the GOA eliminated virtually all restrictions on domestic and foreign trade of goods and services, as well as on financial markets. These policies increased competition in many industries and sectors. Argentine authorities, including the Ministry of Economy and a number of quasi-independent regulatory entities, have also generally acted to foster competition and protect consumers, though not always in a transparent fashion.

Frequent changes to the bankruptcy law during early 2002 increased creditor insecurity. In January 2002, the Argentine National Congress passed several amendments to the bankruptcy law that increased debtors' powers considerably, but the National Congress restored many of the law's earlier protections for creditors in May of that year.

Other regulatory changes in 2002 added to creditor insecurity. The GOA announced in May 2002 that an emergency decree passed in late 2001 had voided the presidential decree that authorized oil and gas companies to keep 70 percent of their foreign exchange revenues offshore. This decree formed the financial basis for most foreign investment in the Argentine oil sector. The GOA's discovery that the decree had been voided inadvertently months before came at a time when it was worried about its access to foreign exchange and the devaluation of the peso. When the peso began to appreciate in late 2002/early 2003, the government of Argentina issued a new decree that gave the industry the same right to withhold 70 percent of revenues starting January 1, 2003, but the industry remains liable for failing to repatriate 100 percent of its revenues during the 13-month period from December 2001 and December 2002. The Central Bank opened proceedings against some oil and gas producers in 2004 for alleged criminal breach of the exchange regime. According to the Central Bank, as of December 2007, one judgment in these cases has been rendered in favor of the involved company. Remaining cases are still pending.

The GOA's actions since 2003 have not calmed investor concerns about the regulatory environment. The GOA issued a decree depesifying foreign currency-denominated contracts of foreign firms doing business in Argentina in 2003, but then withdrew the decree and said it was a mistake. In the energy sector, the GOA took measures to avoid energy shortages that arose from the increase in demand for natural gas and electricity in 2004, including ordering reductions in natural gas exports to Chile and electricity exports to Uruguay; importing natural gas from Bolivia and electricity from Brazil; raising tariffs for industrial users; providing incentives to small users to save energy; and intervening in the wholesale markets for natural gas and electricity.

The GOA has also encouraged companies to invest in the expansion of natural gas pipelines, and has encouraged power companies to invest compensation owed them by the GOA in new power generation plants. There is concern that the

aforementioned GOA actions in the energy sector, coupled with the GOA's efforts to control retail prices of fuels, have created disincentives for companies to invest in energy exploration and infrastructure. Inadequate investment in those areas could, in turn, result in energy supplies not keeping pace with demand generated by Argentina's rapid economic growth.

In response to significant energy shortages during Argentina's July/August 2007 winter season, the GOA mandated several weeks of cutbacks in electricity and gas consumption by major wholesale consumers. This action caused a slight decrease in industrial production, rolling blackouts in major urban areas, and cutbacks in the availability of compressed natural gas used by many automobiles and most taxis. In December 2007, President Cristina Fernandez de Kirchner announced a National Energy Saving Plan with measures that include seasonal time changes, regulation of energy use in public buildings and incentives for consumers to adopt more energy-efficient home appliances.

In November 2007, the GOA moved to end export tax exemptions for several mining companies, and imposed a federal levy on mineral exports, ranging from five percent to ten percent. A number of industry participants have characterized the action as a significant departure from Argentina's 1993-era mining law, which guaranteed tax stability for 30 years, and several are seeking redress through the courts. The new system is still being implemented as of the drafting of this report.

In general, national taxation rules do not discriminate against foreigners or foreign firms (e.g., asset taxes are applied to equity possessed by both domestic and foreign entities). Nevertheless, a number of these taxes may impact their investment decisions. As noted above, in June 2003, the government of Argentina announced that it would review more closely the tax declarations of foreign corporations operating in Argentina. The professed aim of this measure is to crack down on the use of offshore shell corporations to shelter profits and assets from taxation.

At the national level, there are four major taxes: value-added tax (VAT), income tax, export taxes, and a financial transactions tax. The income tax is assessed on income earned by companies, at a rate of 35 percent, and on individuals at a rate ranging from 9 percent to 35 percent. The income tax law presumes that every company earns a profit, and based on this presumption, all firms are required to pay one percent of the value of their assets involved in the production process to the state. If a company is later able to establish that it did not earn a profit, the company will be reimbursed within five years. Export taxes are tariffs imposed on the export of goods, with rates from five percent to 45 percent. The financial transactions tax imposes a 1.2 percent on checking and savings account transaction within the national banking system. The VAT is set at 21 percent for most products. The VAT is 10.5 percent for interest and commissions on debts taken by public transportation companies, fruits, vegetables, honey, newspapers and magazines, and some capital goods. The VAT is 27 percent for natural gas, electricity, water, and sewage services. Exporters are entitled to receive VAT rebates, but many companies report that have experienced extensive delays in their receipt of the rebates.

At the provincial level, the system of provincial sales taxes has encouraged vertical integration of firms. Investors also have expressed increasing concern over the incidence of municipal "supply taxes." The Argentine constitution gives municipalities the right to set fees for the services that they provide, including supply fees. Many investors allege that the supply fees charged by municipalities do not correspond to the services provided. Municipalities have levied fees on the food industry, in particular, through a range of sanitary controls that

occasionally overlap national and provincial regulations. Supply tax fees have affected other industries as well. Municipalities in Buenos Aires and Cordoba provinces have generated the most serious complaints. Many municipalities have begun imposing fees on any advertising visible from the public street, including in-store promotion materials, such as soft drink coolers, ashtrays, and the packaging of individual consumer items, such as batteries.

Efficient Capital Markets and Portfolio Investment

¶9. Law 17811 of 1968 regulates public securities offerings. The Argentine Securities and Exchange Commission (Comision Nacional de Valores) is the federal agency that regulates securities markets offerings. Securities and accounting standards are transparent and consistent with international norms.

U.S. banks, securities firms, and investment funds are well represented in Argentina and are dynamic players in the local capital markets. In July 2003, the government began requiring foreign banks to disclose to the public the nature and extent to which their foreign parent banks guarantee their branches or subsidiaries in Argentina. The private pension fund system -- consolidated in 1995 -- provided a growing base for capital markets until the 2001-2002 economic and financial crises. Following the government's 2005 debt restructuring, private pension funds have again become significant players in domestic capital markets.

In October 2007, the government introduced new regulations requiring the private pension funds (the AFJPs) to gradually reduce their investments in Mercosur countries (the majority of which are in Brazilian financial assets) in a move apparently designed to increase the liquidity and depth of domestic capital markets. According to previous rules governing investments, AFJPs could invest ten percent of their portfolios in foreign assets. However, investments in Mercosur countries were excluded from this ten percent limit, meaning that AFJPs could account for them as domestic assets. To preclude sudden large foreign exchange inflows, the government resolution calls for the gradual reduction of Mercosur investments, beginning with a cap of eight percent of total assets in December 2007, falling to six percent in April 2008, four percent in August 2008, and ending at two percent in December 2008. By December 2008, returned funds should total about 8 billion pesos (roughly \$2.5 billion), according to local analysts.

Political Violence

¶10. Since the 2001/2 economic crisis, protests, marches, and roadblocks directed at the national, provincial and municipal governments, as well as some multinational companies, have been commonplace in Argentina, but their number, size, and the likelihood of accompanying violence have decreased since the crisis. There have been no cases of overtly political violence since the April 2003 national presidential election. In 2005, there were approximately 20 incidents in which local groups were involved in bombings, attempted bombings, or arson, mostly against U.S. businesses (Citibank, Bank Boston, Blockbuster, and McDonald's in particular). Anti-American pamphlets or graffiti were found at most of the 2005 incidents, none of which resulted in injury or death. Since these 2005 incidents, no other such events have occurred.

In protest against the construction, and the October 2007 completion, of a \$1.2 billion pulp mill on the Uruguayan side of a river that defines the Argentine/Uruguay border, Argentine citizens have since December 2006 completely blocked one of three bridges that connects the two nations,

and periodically blocked the other two bridges that connect them. The pulp mill project is being financed and insured by World Bank agencies and has met all relevant World Bank environmental safeguards. The Mercosur trade bloc's arbitral tribunal considered the case in 2006 and found the blockade illegal and a violation of the right of free transit of goods and services in the region, but imposed no sanctions (and lacks enforcement authority). The Governments of Argentina and Uruguay have asked the International Court of Justice for an opinion on whether construction of the plant violated a 1975 Argentine-Uruguayan treaty dealing with its shared river, and a decision is expected in 2008.

Corruption

¶11. Government corruption and private sector business fraud are the subjects of frequent complaints from U.S. investors. U.S. businesses have identified corruption in Argentina as a significant problem for trade and investment, particularly in procurement, regulatory systems, tax collection, and health care administration. Some foreign firms also complain that their adherence to the letter of the tax and regulatory codes places them at a competitive disadvantage.

Transparency International (TI) has a local chapter in Argentina. In the latest TI Corruption Perceptions Index (CPI) that ranks countries and territories by their perceived levels of corruption, Argentina ranked 105 out of 180 countries and territories, below the average among Latin American countries, and far behind neighbors Chile and Uruguay. Such surveys have contributed to more open debate in Argentina about corruption and fraud. There are indications that the GOA is trying to change the culture of tax evasion by stepping up enforcement efforts and encouraging the use of credit card purchases while at the same time using the media to increase public awareness of tax obligations and to shame evaders. While Argentina's growing economy is primarily responsible for the government of Argentina's solid fiscal performance, anti-evasion efforts were a factor in the federal government's record tax collections of about 200 billion pesos in 2007, up from around 163 billion in 2006 and 150 billion in 2005.

In 2007, a major corruption investigation involving alleged bribe payments by employees of a foreign multinational corporation to government authorities has been widely reported in the press. The ensuing investigation has reportedly significantly delayed a planned expansion of Argentina's natural gas pipeline network. Also in 2007, a federal congressman denounced an attempt by a foreign multinational to pay a bribe in exchange for supporting legislation favorable to the company's future business. Media reports that the Foreign Ministry plans to take this case to the OECD Anti-Corruption Committee.

Argentina is a party to the OAS Anti-Corruption Convention and ratified the OECD Anti-Corruption Convention in 2001. Argentina has signed and ratified the UN Convention Against Corruption (UNCAC). It is an active participant in UNCAC's Conference of State Parties and is participating in the pilot review of the implementation of UNCAC. It is also an active participant in the Mechanism for Follow-up on the Implementation of the Inter-American Convention Against Corruption (MESICIC). The government has regulations against bribery of government officials, but enforcement is uncertain. An anti-corruption office under the Ministry of Justice reviews the financial disclosure statements that are now required of all senior public officials. The Anti-Corruption Office (ACO) also carries out investigations into cases of alleged corruption involving Executive branch officials or in matters involving federal funds, except for funds transferred to the provinces. Although nominally a part of the judicial branch, the ACO does not have authority to independently prosecute cases, but can refer

cases to other agencies or serve as the plaintiff and request a judge to initiate a case. The majority of high-profile corruption cases, however, are investigated by individual judges. These judges, however, may request assistance from the ACO in gathering or analyzing evidence, especially when related to complicated financial transactions.

A recent ACO investigation of GOA public purchases between 2002 and 2005 revealed that about 75 percent were accomplished via direct contracts, often with a sole provider, and not via public tenders. The ACO report expressed concern that this process can facilitate corruption and does not allow competition among providers. The ACO report noted that some GOA officials defended this practice, claiming that many contracts were below the legally-mandated limit of 10,000 pesos (about USD 3200), under which tenders are not required. GOA officials also claimed that sometimes only one provider was able to meet contract specifications. In response, the ACO report noted that GOA officials often avoided the 10 thousand peso limit by disaggregating contract components so that no part exceeded this limit, that contract specifications were sometimes written so that only one provider could meet the requirement, or failed to widely advertise tenders so that other providers could be made aware of them.

Inefficiencies in the Argentine judicial system slow efforts to stem corruption. Argentine laws do not provide for plea-bargaining, so many corruption charges are difficult to prosecute. As a result, convictions are rare.

Bilateral Investment Agreements

¶12. The governments of Argentina and the United States signed a BIT in 1991. The agreement was amended, ratified by the Congresses of both countries, and entered into force on October 20, 1994. The Argentina-United States BIT can be found on the following site:
[http://www.state.gov/documents/organization/4 3475.pdf.htm](http://www.state.gov/documents/organization/43475.pdf.htm). Argentina does not have a bilateral tax treaty (Treaty for the Mutual Avoidance of Double Taxation) with the United States.

At present, the GOA has signed and ratified bilateral treaties for the protection and promotion of investment with all of its major trade and investment partners. More information regarding Argentina's bilateral tax and investment treaties is available at www.infoleg.gov.ar.

Argentina has valid double taxation treaties with the following countries: Australia, United Kingdom, Denmark, Germany, Belgium, Austria, France, Italy, Sweden, Switzerland, Spain, Canada, Chile, Bolivia, Brazil, Finland, Norway, and the Netherlands. In addition, a number of treaties concerning the exemption of income from international transport are in force.

OPIC and other investment insurance programs

¶13. The government of Argentina signed a comprehensive agreement with the Overseas Private Investment Corporation (OPIC) in 1989. The agreement allows OPIC to insure U.S. investments against risks resulting from expropriation, inconvertibility, war or other conflicts affecting public order. OPIC programs are currently used in Argentina. Argentina is also a member of the World Bank's Multilateral Investment Guarantee Agency (MIGA).

Labor

¶14. Argentine workers are among the most highly educated in

Latin America. Argentine workers were relatively well paid by international standards prior to the peso devaluation in January 2002. While high inflation following the 2002 devaluation significantly eroded the purchasing power of wages, sustained government-promoted increases in public and private sector nominal wage levels from 2003 have reversed this trend. Wages in dollar terms remain competitive, even taking into account Argentina's relatively high social security charges and other taxes. As of the third quarter of 2007, the official unemployment rate was 8.1 percent, down from a 21.5 percent peak in 2002, but this number excludes recipients of government assistance to unemployed heads of households. If those recipients were included, unemployment would be approximately 8.8 percent. According to the Ministry of Labor, about 44 percent of workers 14 years and older work in the informal sector.

Organized labor continues to play a strong role in Argentina. Sector-specific negotiations between unions and industry, although largely market-driven, have often been influenced by government suasion on behalf of unions. In the 2002-2004 period, a number of general wage increases were mandated by presidential decree.

Argentine law provides unions with the right to negotiate collective bargaining agreements and to have recourse to conciliation and arbitration. The Ministry of Labor, Employment, and Social Security ratifies collective bargaining agreements, which covered roughly 75 percent of the formally employed work force. According to the ILO, the ratification process impeded free collective bargaining because the ministry considered not only whether a collective labor agreement contained clauses violating public order standards but also whether the agreement complied with productivity, investment, technology, and vocational training criteria. However, there were no known cases during the year of government refusal to approve any collective agreements under these criteria. There are no special laws or exemptions from regular labor laws in the foreign trade zones.

With the unemployment rate now below nine percent, numerous employers continue to comment on an increasing shortage of skilled labor. The GOA passed a modest labor reform law in 2000 to address rigidities in the labor market (i.e., increasing collective bargaining flexibility, extending trial employment periods, and lowering payroll taxes for new permanent hires). However, the anticipated growth in employment did not materialize, as the reforms coincided with a deepening of the economic recession produced by foreign and domestic factors. Following the acceleration of the financial crisis beginning in December 2001, many workers left the formal labor force and instead began to work informally, as employers sought to avoid high pension, social security, and other taxes on formal employment. In an effort to avoid massive layoffs during the 2002 financial crisis, severance payments were doubled. This "double indemnification" labor termination policy was ended in September 2007 when official unemployment dropped below ten percent. According to the World Bank's "Doing Business" survey compiled before this double indemnification policy was ended, the cost of terminating an employee in Argentina averaged 139 weeks of wages, almost double the Latin American average of 59 and more than four times the OECD average of 31.

Foreign Trade Zones/Free Ports

¶15. Argentina has two types of tax-exempt trading areas: Foreign Trade Zones (FTZs), which are found throughout the country; and the more comprehensive Special Customs Area (SCA), which covers all of Tierra del Fuego Province and whose benefits apply only to already established firms.

Law 24331 of 1994 establishes the FTZ regime for Argentina.

Argentine law defines an FTZ as a territory outside the "general customs area" (GCA, i.e., the rest of Argentina) where neither the inflows nor outflows of exported final merchandise are subject to tariffs, non-tariff barriers, or other taxes on goods. Goods produced within a FTZ generally cannot be shipped to the GCA, unless they are capital goods not produced in the rest of the country. The labor, sanitary, ecological, safety, criminal, and financial regulations within FTZs are the same as those that prevail in the GCA. Foreign firms get national treatment in FTZs.

Under the current law, the Executive Power may create one FTZ per province, with certain exceptions. More than one FTZ per province may be allowed in sparsely populated border regions (although this provision has not been fully utilized). Thus far, the National Executive Power has permitted FTZs in most of the 24 Argentine provinces. The most active FTZ is in La Plata, the capital of Buenos Aires Province.

Merchandise shipped from the GCA to a FTZ may receive export incentive benefits, if applicable, only after the goods are exported from the FTZ to a third country destination. Merchandise shipped from the GCA to a FTZ and later exported to another country is not exempt from export taxes. Any value added in FTZs and re-exports from FTZ is exempt from export taxes.

Law 19640, passed in 1972, codifies the Special Customs Area (SCA) rules for Argentina. Unlike FTZ-manufactured goods, products manufactured in an SCA may enter the GCA free from taxes or tariffs. In addition, the government may enact special regulations that exempt products shipped through an SCA (but not manufactured therein) from all forms of taxation except excise taxes. The SCA program provides benefits for established companies that meet specific production and employment objectives.

The SCA program applies only to Tierra del Fuego Province. The government reduced some SCA benefits in the early 1990s. Some of these benefits were later reestablished, but only for those firms previously established in Tierra del Fuego Province. The SCA program is scheduled to expire at the end of 2013. In late 2006, Economic Ministry Resolution 776 abolished export tax exemption enjoyed by oil companies operating in Tierra del Fuego Province.

Foreign Direct Investment Statistics

¶16. According to the United Nations Conference on Trade and Development (UNCTAD) World Investment Report 2007, the total stock of FDI in Argentina at the end of 2006 was estimated at \$58.6 billion. Spain, the United States, and France remain the top three investors. Other important sources of investment capital include Brazil, Canada, Mexico, U.K., Italy, Chile, the Netherlands and Germany.

Also according to UNCTAD, Argentina received 1.3 percent of foreign direct investment (FDI) inflows to developing countries, and 5.7 percent of FDI inflows to Latin America and the Caribbean in 2006. Both of these shares are well below Argentina's average FDI share from the pre-crisis 1992-2000 period. Total FDI inflows in 2006 were estimated at \$4.8 billion. The stock of U.S. FDI in Argentina in 2006 was estimated at \$13 billion. U.S. investment is concentrated in financial services, agribusiness, energy, petrochemicals, food processing, household products, and motor vehicle manufacturing. Many U.S. firms substantially wrote down the value of their Argentine investments in response to the devaluation and pesification of previously dollar-denominated contracts.

Argentine firms increasingly invested abroad during the 1990s (particularly in Brazil, Paraguay and Uruguay), although the country has remained a net recipient of

foreign direct investment. In 2006, according to UNCTAD, its outward FDI amounted to \$2.0 billion.

The Argentine Ministry of Economy (<http://www.mecon.gov.ar>) and the Investor's Information Service for Argentina (<http://www.infoarg.org>) have additional detailed information on foreign direct investment in Argentina.

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